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No. 93-1535

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

WEST PENN POWER COMPANY,
ARMCO ADVANCED MATERIALS COMPANY
and ALLEGHENY LUDLUM CORPORATION,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and MON VALLEY ENERGY CORPORATION,
Respondents.

On Petition for a Writ of Certiorari to the Commonwealth Court of Pennsylvania

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BRIEF IN OPPOSITION FOR RESPONDENT MON VALLEY ENERGY CORPORATION

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RULE 29.1 STATEMENT

The parent company of Mon Valley Energy Corporation is Sagamore Corporation, a Connecticut corporation. Mon Valley is a general partner in a limited partnership known as Mon Valley Limited Partnership, which has, as its other general partner, CMS Generation Mon Valley Company, a Michigan corporation.

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BRIEF IN OPPOSITION FOR RESPONDENT MON VALLEY ENERGY CORPORATION

INTRODUCTION

The Petition for Writ of Certiorari does not present any issue warranting this Court's review. Petitioners West Penn Power Company ("West Penn"), Armco Advanced Materials Company ("Armco") and Allegheny Ludlum Corporation ("Allegheny") seek review of a decision of the Pennsylvania Commonwealth Court that the Pennsylvania Supreme Court declined to review. In arguing that these Pennsylvania decisions are not in accord with the federal policy underlying the Public Utility Regulatory Policies Act of 1978 ("PURPA")[1] or with the decisions

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[1] 16 U.S.C. § 824a-3

of other states, the petitioners take extraordinary liberties with the facts and ignore the clear legislative mandate that allowed the individual states to develop their own regulatory schemes to implement the provisions of PURPA.

The Petitioners premise their arguments on the unsupported and fallacious assertion that the Electric Energy Purchase Agreement ("EEPA") between Mon Valley Energy Corporation ("Mon Valley") and West Penn, as modified by the Pennsylvania Public Utility Commission ("PUC"), will result in costs that are not "just and reasonable" to West Penn's customers. However, a review of the history of this proceeding reveals that calculation of the "avoided cost" rate contained in the EEPA is the subject of a separate proceeding that is currently before the PUC. The record before this Court reflects only the determination that the PUC can modify the terms of an EEPA presented to it for review to ensure that the agreement conforms with the provisions of PURPA.

The Petitioners also argue that the PUC exceeded its authority by modifying what they characterize as a "private contract." Yet, it was Armco and Allegheny's insistence on participation in the PUC's process for reviewing certain agreements between several "qualifying facilities" and West Penn that highlighted the fact that a PURPA agreement that is subject to public review is not a purely private contract. As joint petitioners to this Court with West Penn, Armco and Allegheny now insist that the Mon Valley EEPA was purely private. As the Pennsylvania Commonwealth Court recognized, modification of the agreement, particularly certain milestone dates,[2] was required to preserve the contract during the extensive review process which Armco and Allegheny sought and obtained.

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[2] The "milestone dates" in the EEPAs include the dates of several good faith deposits, the date of financing closing and the in-service date for the facility. Under the terms of the EEPAs, if any of these milestone dates were not met, the EEPAs would expire.

The decision of the Pennsylvania Commonwealth Court implements the policy goals that led to the enactment of PURPA. The Pennsylvania Supreme Court properly decided to decline to review the Commonwealth Court's decision. By misrepresenting the record and the reasoning and holdings of the Pennsylvania Commonwealth and Supreme Courts, Petitioners essentially ask this Court to substitute the Pennsylvania PUC's reasonable determination that was based on record evidence and affirmed by the Pennsylvania Commonwealth Court, with the unsupported representations of the utility and two of its industrial customers.

Certiorari would not be warranted even if the issues stated in the Petition were supported by the record. The regulations and case law developed in Pennsylvania do not reflect a divergence from the underlying philosophy of PURPA but the flexibility in implementation of PURPA. Because the courts of Pennsylvania correctly applied PURPA and because their decisions do not represent a conflict with the highest court of any other state, certiorari is not warranted.

STATEMENT OF THE CASE

A. Project at Issue

The Shannopin Project, developed by Mon Valley, is a qualifying cogeneration facility or "QF" [3] within the

[3] The regulations define a "qualifying facility" as a cogeneration or a small power production facility which meets the size, ownership, operating, efficiency and fuel use criteria contained in the regulations. 18 C.F.R. § 292.101(a). The statute defines a "cogeneration facility" as a facility which produces electric energy and steam or other forms of useful energy which are used for industrial, commercial, heating or cooling purposes. 16 U.S.C. § 796(18)(A). A "small power production" facility produces electric power from biomass, waste, or renewable resources such as wind, water, or solar energy. 16 U.S.C. § 796(17)(A). Under the Act, qualifying facilities are entitled to a rate based on the incremental cost to the utility of building new generating capacity of its own

meaning of PURPA and the regulations of the Federal Energy Regulatory Commission ("FERC") implementing the Act. 16 U.S.C. § 824a-3; 18 C.F.R. §§ 292.205 and 206. The Shannopin Project was designed as an 80 megawatt facility to be located in Greene County, Pennsylvania. In October, 1987, Mon Valley entered into an EEPA with West Penn under which Mon Valley was to sell the electric capacity and energy from the Shannopin Project to West Penn. The "avoided cost" rate contained in the Mon Valley EEPA was based on West Penn's need, as presented in its public filings with the PUC, for three 300 megawatt coal-fired units and represented a discount from West Penn's "full avoided costs."

B. Procedural History

1. *Regulatory Review Requirement*

The procedural history of the case at issue is inextricably intertwined with the decisions of the Pennsylvania courts in the other cases involving QF projects that entered EEPAs with West Penn.[4] West Penn initiated this proceeding in January, 1988, when it submitted the Mon Valley EEPA to the PUC for approval. The PUC issued tentative approval of the agreement on July 8, 1988. Appendix E. The PUC had also issued tentative approval of another project that had entered an EEPA with West

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or purchasing energy from another facility, i.e., the utility's "avoided costs." 18 C.F.R. § 292.304. "Avoided costs" are defined as the "incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(a)(6).

[4] See, e.g., *Armco Advanced Materials Corporation* v. *Pennsylvania Public Utility Commission*, 135 Pa.Commw. 15, 579 A.2d 1337, *aff'd per curiam*, —— Pa. ——, 634 A.2d 207 (1993), *petition for certiorari filed*, No. 93-1341 (*"Milesburg II"*); *Armco Advanced Materials Corporation v. Pennsylvania Public Utility Commission*, 157 Pa.Commw. 150, 629 A.2d 221 (1993), *appeal denied*, —— Pa. ——, —— A.2d —— (1994) (*"Burgettstown II"*).

Penn, known as the Milesburg Project. Like the Shannopin Project, the Milesburg Project was to replace a portion of West Penn's planned three 300 MW coal-fired units at a rate based on West Penn's avoidance of those units.

In the Milesburg proceeding, however, Armco and Allegheny filed an appeal to the Pennsylvania Commonwealth Court, arguing that they, as ratepayers, should have the right to participate in an evidentiary hearing to aid the PUC in the evaluation of the EEPA between Milesburg and West Penn. In effect, the industrial customers argued that the PUC should be required to modify the rate contained in the agreements if it found that those rates exceeded the utility's avoided costs. In *Barasch v. Pennsylvania Public Utility Commission,* 119 Pa.Commw. 81, 546 A.2d 1296 (1988), *appeal denied,* 523 Pa. 652, 567 A.2d 655 (1989) (*"Milesburg I"*), the Pennsylvania Commonwealth Court agreed with Armco and Allegheny and held that West Penn was required to notify its customers of proposed EEPAs and that the PUC was required to conduct an evidentiary hearing with respect to the EEPAs in which the customers were entitled to participate.

2. Bifurcation of Proceeding

Following *Milesburg I,* the PUC consolidated for review the proceedings involving four projects that had entered EEPAs with West Penn including the Milesburg, Shannopin and Burgettstown Projects. An Administrative Law Judge ("ALJ") of the PUC conducted a two-week hearing in April, 1989 during which he examined the EEPAs for the projects. The ALJ addressed the two primary issues raised in the hearing in separate phases. Phase I addressed the calculations of the avoided cost rates in the agreements. Phase II addressed the extension of milestone dates in the Milesburg and Burgettstown EEPAs. Because the milestone dates in the Mon Valley EEPA were significantly later than those in the other EEPAs, modification of the Mon Valley EEPA was not addressed.

3. *Phase I Issues*

With respect to Phase I, the industrial customers questioned the appropriate time to calculate the rates contained in the EEPAs. The calculations of the rates were made as of 1986, the time the parties reached agreement in principle on the rate, i.e., the time of "serious negotiations." The industrial customers argued that the rate should be calculated as of the date of contract execution.

At the time of the hearing in 1989, neither the utility nor the industrial customers, the Petitioners here, argued that the utility had no need for the capacity represented by the QFs. Neither the utility nor the industrial customers argued that it was inappropriate to use as the basis for the rate calculations the three 300 MW coal-fired units that were considered the avoided units for the calculations contained in the EEPAs. In fact, the ALJ concluded that West Penn had submitted substantial evidence to support the use of the coal units as the basis for the avoided cost calculations. (169a).

In Phase I, the PUC approved the rates contained in the Mon Valley, Milesburg and Burgettstown EEPAs as based on the coal units. It held that the capacity rates had been properly calculated as of the time of "serious negotiations." Armco and Allegheny appealed the PUC's decision with respect to the Mon Valley EEPA on the narrow issue of whether 1986 or 1987 tax rates should be used for the calculation. They did not contend that the rates were based on unneeded capacity.

On July 17, 1990, the Commonwealth Court issued its decision in *Milesburg II*. The court accepted Armco and Allegheny's argument with respect to Phase I and found that, under the federal PURPA regulations at 18 C.F.R. § 292.304(d), the rate must be calculated as of the time the QF had "legally obligated" itself to deliver capacity to the utility. The court concluded that the "legally enforceable obligation" was incurred at the time the QF entered a contract with the utility. 135 Pa.Commw. at 30, 579

A.2d at 1345. The court remanded the proceeding to the PUC for recalculation of the rate using input appropriate as of the contract date.

In *Shannopin I*, an unpublished decision that was issued the same day as *Milesburg II*, the Commonwealth Court followed its rationale in *Milesburg II* with respect to Phase I. See, Appendix L. Arguing that the rate in the agreement could not be changed, West Penn sought review of *Shannopin I*. The Pennsylvania Supreme Court declined to hear the appeal. Appendix N. The calculation of the rate for the Shannopin Project as of the date of the contract is the subject of a separate proceeding that is currently before the PUC. Appendix Y.

4. *Phase II Issues*

Because they faced the imminent expiration of several milestone dates contained in their EEPAs, at the April, 1989 hearing, the Milesburg and Budgettstown Projects asked that the PUC modify their agreements to reflect the delays caused by the *Milesburg I* litigation and the newly-required hearing by extending the contract milestone dates.

With its September, 1989 Order approving the rates in the Milesburg, Budgettstown and Mon Valley EEPAs, the PUC also granted the requested modifications to the Milesburg and Budgettstown EEPAs. The PUC acknowledged the impact of requiring administrative review of the EEPAs as a result of *Milesburg I* and noted:

> In our view it is essential that regulatory delay in the proceeding be recognized and reflected in our Order. To do otherwise would merely extend an open invitation to interventions in opposition to future QF proceedings since intervenors would realize that they could win by default, through the passage of time alone, results that could not be won on the merits.

(258a).

West Penn, Armco and Allegheny appealed the PUC's modification of the Milesburg and Budgettstown EEPAs to the Pennsylvania Commonwealth Court. They maintained that the PUC lacked the authority to modify the EEPAs.

With respect to Phase II, the Commonwealth Court, in *Milesburg II*, affirmed the PUC's exercise of its authority to modify the terms of the EEPA to ensure that they complied with the FERC regulations and the goals of PURPA and to ensure that the regulatory review did not result in the termination of the projects. The court recognized that because West Penn submitted the EEPA to the PUC for approval and because customers were entitled, under *Milesburg I*, to participate in the PUC's review process, the EEPA was no longer a purely private instrument.

The court found that, unlike a private contract, an agreement submitted to the PUC for approval was the functional equivalent of a petition by the QF asking the PUC to compel the utility to enter into a contract. It concluded:

> In our view, the PUC has full discretion in its exercise of its powers under PURPA and the FERC regulations to encourage the development of cogeneration and small power production to ensure that litigation delays do not become the factor that determines whether a project succeeds or fails.

135 Pa. Commw. at 38-9, 579 A.2d at 1349-50.

The Commonwealth Court reiterated that the QF had incurred a "legally enforceable obligation" to the utility as of the time it entered a contract with the utility. The court held, however, that the permitted milestone-related modifications did not result in a new "legally enforceable obligation."

The Pennsylvania Supreme Court accepted *Milesburg II* for review and affirmed the Commonwealth Court's decision *per curiam* with respect to both Phase I and

Phase II. Although equally divided with respect to the Phase I decision as to whether a "legally enforceable obligation" had been established at the time of "serious negotiations" or contract signing, the court unanimously agreed that the PUC had the authority to preserve the contract by modifying it.[5]

5. *Mon Valley's Phase II Proceeding*

Following the PUC's approval of the Mon Valley EEPA in 1989 and while awaiting the Commonwealth Court's decisions in *Milesburg II* and *Shannopin I*, Mon Valley realized that the lengthy litigation would require it, like the Milesburg and Burgettstown projects, to request an extension of certain milestone dates in its EEPA. Thus, in April, 1990, Mon Valley filed a petition with the PUC requesting that its EEPA be modified by the extension of milestone dates and the adjustment of the rate to reflect the later in-service date of the facility. The same ALJ who had conducted the April 1989 hearings presided over an evidentiary hearing on the proposed modifications to the Mon Valley EEPA.

In late 1990, it became necessary to clarify the scope of the hearing. In the pre-filed direct testimony of two of its witnesses, West Penn first asserted that the recalculated rate for the project should not be based on the cost of avoiding its previously planned large coal units of which the project was to replace a small portion. Instead, West Penn suddenly contended that, back in 1987, it did not have a need for any capacity and thus, according to West Penn, the only "avoided cost" rate to which Mon Valley

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[5] Mr. Justice Papadakos, joined by two other justices, authored a brief opinion in which he questioned the court's decision with respect to Phase I. With respect to the Phase II modification issue, however, Mr. Justice Papadakos and the justices who joined his opinion, agreed that the Commission properly exercised its authority in modifying the agreement. Thus, although the Petitioners refer to the court as being "equally divided," in fact, with respect to the salient issue here, the court was unanimous.

was entitled was zero. On this contrived basis, one of West Penn's witnesses maintained that any rate in excess of zero would result in excessive costs to the utility's customers.

West Penn never reconciled its assertion that it had no need for capacity in 1987 with the fact that, in 1987, it had signed the Mon Valley EEPA, as well as other EEPAs, to replace the utility-owned coal units on which the rates for the EEPAs were based. Neither did West Penn attempt to explain why, in 1989, in the hearing that addressed the rates contained in the EEPA, it had never alleged a change in its capacity needs and in fact, had presented substantial evidence to support its need for the three 300 MW coal units.

The ALJ did not accept West Penn's "zero avoided costs" argument and struck West Penn's testimony as to its representations of its capacity needs.[6] He also held that the issues relating to West Penn's need for capacity and the calculation of avoided costs were to be addressed in the remanded portion of Phase I which had not yet been returned to the PUC as it was subject to West Penn's petition for allowance of appeal pending before the Pennsylvania Supreme Court.[7]

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[6] West Penn maintained, in 1990, that its 1987 planning documents showed no utility-owned coal units and that, therefore, its avoided costs as of 1987 were zero. The ALJ recognized, however, that in 1986, West Penn had acknowledged a need for 900 MW of coal-fired capacity and that by 1987, it had substituted in its plans 17 PURPA projects, including the Milesburg, Burgettstown and Shannopin Projects, to meet the 900 MW of need it projected. The fact that West Penn's 1987 plans no longer indicated a need for utility-owned coal units merely reflected the fact that the utility sought to meet that need with PURPA units.

[7] The avoided cost calculation is still before the PUC. See, Appendix Y. In its Tentative Order, the PUC reiterated its finding that West Penn had a need for capacity when it signed the EEPA. (433a).

In reviewing the ALJ's decision to strike the testimony West Penn proffered, both the PUC and the Commonwealth Court held that the testimony had been properly stricken as beyond the PUC's jurisdiction. However, both tribunals noted in dicta the deceptive nature of West Penn's reasoning. In approving the ALJ's decision to strike the testimony, the Commonwealth Court stated:

> Although the stated purpose of the testimony was to establish the capacity needs of West Penn as of the date West Penn and Mon Valley entered the EEPA [1987], the testimony essentially suggests that West Penn had no need for capacity, a curious contention in light of the fact that West Penn entered the EEPA at that time [1987] for the purchase of capacity.

(24a).

The court found that West Penn's allegations regarding its current capacity needs were "disingenuous" based on its conduct. (20a).

In his Recommended Decision following the evidentiary hearing, the ALJ specifically found that the modifications requested by Mon Valley would not affect West Penn's avoided costs as of the date of the established "legally enforceable obligation." (328a). He further found that West Penn's own planning documents indicated West Penn's continued need for the Shannopin Project and that those documents anticipated the extension of the in-service date for the project. (329a). He further concluded, as a matter of law, that the modifications ensured that the EEPA conformed to the FERC regulations and the goals of PURPA by preventing the termination of the EEPA. (376-7a).

The PUC unanimously accepted the ALJ's Recommended Decision and granted the modifications requested. Appendix T. As the PUC recognized, none of the modifications to the EEPA negated the "legally enforceable obligation" the QF incurred when it entered the EEPA.

(390a). West Penn and Armco and Allegheny appealed the PUC's decision to the Commonwealth Court.

In September, 1992, in *Shannopin II*, the decision at issue here, the Commonwealth Court affirmed the PUC's order. Appendix C. In the majority opinion, President Judge Craig, the author of the *Milesburg I*, *Milesburg II*, and *Shannopin I* decisions, held that the PUC had properly exercised its authority to modify the EEPA. He again rejected the argument that the agreement was purely private. He explained:

> [T]here is a basic distinction between a completely privately negotiated contract and one the utility submits to the commission for approval. In the former case, where the terms of the EEPA are not subjected to the commission's scrutiny, the utility bears the risk that the commission, in a later rate proceeding will not approve the utility's request for an increase in rates.

(18-9a).

Judge Craig also specifically rejected the Petitioners' argument that modification of the EEPA resulted in a new date of a "legally enforceable obligation."

In their attempts to create an issue for review, the Petitioners assert that the issue of modification was the subject of "vigorous dispute" before the Commonwealth Court. It is clear, however, that even the dissent was in full accord with the majority in acknowledging the PUC's authority to modify PURPA contracts. Judge Peilegrini noted:

> I do not disagree that the PUC can extend milestone dates set forth in a purchase agreement if necessitated by litigation delay to foreclose the purchase agreement to prevent it from lapsing under its own terms.

(31a).

The dissent focused, however, on responding to Judge Craig's comment in dicta that West Penn's allegations were disingenuous. Judge Pellegrini seemed to accept, without question, West Penn's unsupported assertion that the Shannopin Project represented unneeded capacity and expressed his concern that the testimony relating to West Penn's 1987 forecasts and capacity needs had been stricken. The dissent failed to recognize that the testimony in question related to the Phase I issues that were beyond the jurisdiction of the PUC in reviewing the Phase II issues. In fact, the PUC is currently faced with evaluating West Penn's 1987 forecasts and capacity needs as part of the recalculation proceeding on remand from the Commonwealth Court in *Shannopin I*.[8]

By Order dated December 30, 1993, the Pennsylvania Supreme Court declined to review the Commonwealth Court's decision. Appendix A and B.

REASONS FOR DENYING THE WRIT

I. INTRODUCTION

The Pennsylvania Supreme Court properly declined to review the decision of the Pennsylvania Commonwealth Court in which the court fully considered and correctly applied the law to the record in this case. Although the Petitioners here attempt to ascribe to the Pennsylvania PUC and the Pennsylvania courts a "hidden agenda," the decisions of those tribunals reflect a reasoned application of PURPA in Pennsylvania that does not present any federal question or conflict with another state.

When Congress enacted PURPA, it recognized that the regulatory agencies of the individual states were uniquely situated to address questions of implementation

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[8] Although Petitioners refer to the ongoing calculation proceedings currently before the PUC, they fail to acknowledge that, in the course of those proceedings, the PUC has rejected their contentions relating to West Penn's need for capacity as of 1987. See, Appendix Y.

of the Act. Congress thus directed the states to develop their own regulations implementing the Act. The cases from other states cited by the Petitioners reflect no conflict among the states as to the policy underlying the Act but a variety in methods of implementation of the Act. Pennsylvania's strong preference for evidentiary hearings as a means to protect the due process rights of third parties in the review of PURPA contracts, as reflected in the case at issue here, clearly distinguishes the Pennsylvania regulatory scheme from those developed in other jurisdictions.

The whole of Petitioners' argument is premised on the bald assertion that the contract will result in excessive costs to the utility's customers. Although Petitioners present this claim as an uncontroverted fact, the record reveals that the ALJ, the PUC and the Commonwealth Court expressly rejected the assumption underlying the Petitioners' argument. Further, the determination of the rate for the project and thus, of the cost of the project to the utility's customers, is the subject of a separate proceeding that is currently before the PUC.

Because the decisions below present no conflict with decisions of this Court or of the highest court of any other state, this Court should decline Petitioners' invitation to prolong further the litigation that has engulfed this project.

II. THE REGULATORY SCHEME FOR IMPLEMENTATION OF PURPA IN PENNSYLVANIA ALLOWING UTILITY CUSTOMERS TO PARTICIPATE IN THE REVIEW OF RATES CONTAINED IN PURPA CONTRACTS IS CONSISTENT WITH THE FEDERAL POLICY UNDERLYING PURPA

A. Regulatory framework of PURPA

Congress enacted PURPA as part of the National Energy Act of 1978. The Act was designed to alleviate the dependence of the nation's electric utilities on foreign

oil and natural gas by encouraging the development of cogeneration and small power production facilities. Congress specifically noted that the increased reliance on oil imports had serious implications for both international security and the world economy. It cautioned:

> We must begin now, while there is still time to make adjustments, to change the way Americans use energy and avoid the disruption that could be suddenly thrust upon us from external sources.

H.R. Conf. Rep. No. 95-543, 95th Cong. 2d Sess. (1978) *reprinted at* 1978 U.S. Code & Ad. News at 7675.

As this Court noted in *FERC v. Mississippi*, 456 U.S. 742 (1982):

> Congress believed that increased use of these sources of energy [cogeneration and small power production facilities] would reduce the demand for traditional fossil fuels.

Id. at 750.

Congress recognized that one of the primary deterrents in the development of these alternate capacity resources was the reluctance of utilities to purchase from these facilities. *Id.* at 750-1 and n.12. With PURPA, it created a federal statutory duty requiring electric utilities to purchase from qualifying facilities or "QFs." 16 U.S.C. § 824a-3(a). This case highlights the resistance of one utility to complying with that duty.

PURPA dictates that state regulatory authorities, with their expertise and knowledge of local conditions, be the primary enforcers of the Act. The Act requires the FERC and state regulatory authorities to adopt rules implementing the Act. 16 U.S.C. § 824a-3(f). It further affords great latitude to the state agencies in effectuating the purposes of the Act. PURPA § 16 U.S.C. § 824a-3(f); 45 Fed.Reg. 12230-31 (1980). The FERC promulgated regulations implementing PURPA specifically provide that states may take "any action reasonably designed to imple-

ment" the provisions of PURPA. 18 C.F.R. § 292.401 (a). In effect, Congress charged state regulatory agencies with developing a procedure either by regulations or adjudications under which utilities could be compelled to purchase energy from QFs.

This Court approved the flexibility afforded to the states in *FERC v. Mississippi*. This Court observed:

> a state commission may comply with the statutory requirements by issuing regulations, by resolving disputes on a case-by-case basis, or by taking any other action reasonably designed to give effect to FERC's rules.

Id. at 751.

There, this Court found that the regulatory scheme in PURPA, in which the federal government sought to use state regulatory machinery to advance federal goals, was constitutional. *Id.* at 758. The Court held that PURPA "does nothing more than pre-empt conflicting state enactments in the traditional way." *Id.*

PURPA requires utilities to purchase capacity from QFs at rates which must be "just and reasonable" to the consumer and "in the public interest." The Act also requires that the rate paid to a QF should not exceed the utility's avoided cost of alternate energy. As this Court recognized in *American Paper Institute, Inc. v. American Electric Power Service Corporation*, 461 U.S. 402 (1983), a rate that does not exceed the utility's avoided costs is *per se* "just and reasonable." *Id.* at 417.

B. Pennsylvania requirement of due process hearing to review PURPA contracts

In Pennsylvania, the regulations promulgated by the PUC follow the federal regulations. 52 Pa.Code §§ 57.31 *et seq.* The additional requirement of an extensive evidentiary review of PURPA contracts submitted to the Pennsylvania PUC for approval developed as the result

of the Commonwealth Court's decision in *Milesburg I*. Although the Petitioners here relegate discussion of *Milesburg I* to a footnote, the impact of that decision on the regulatory review process for PURPA contracts in Pennsylvania is significant.

In that case, the same industrial customers that petition this Court argued that they were entitled to a hearing to address the rate contained in the EEPA. The underlying premise of Armco and Allegheny's argument was that because an EEPA could affect ratepayers, it was not purely private. The court agreed with the utility customers and held that the ratepayers were entitled to some form of due process protection. It thus directed the PUC to provide a forum in which the ratepayers could participate and directed the utility to provide notice of the PUC's hearing to each of its thousands of customers.

Milesburg I thus expanded the regulatory requirements of PURPA in Pennsylvania. In addition to the PUC's inherent obligation to review PURPA arrangements between utilities and QFs, third parties were suddenly allowed to contest provisions of an agreement between a QF and a utility. Thus, the particular terms of the instrument could no longer be considered those of a purely private agreement. As a result of the court's determination in *Milesburg I*, the PUC is required to conduct a full evidentiary review of PURPA contracts submitted to it for approval.

C. In *Milesburg II*, the Commonwealth Court recognized the authority of the PUC to modify contracts that do not conform to PURPA

In *Milesburg II*, the Commonwealth Court correctly recognized that allowing the date of an EEPA to pass, pending the administrative hearing required by *Milesburg I*, contradicted the PUC's directive under PURPA to encourage the development of QFs. *Milesburg II*. The Commonwealth Court also understood that because other parties were entitled to participate in the administrative

process, an EEPA submitted to the PUC for approval was not a purely private agreement between two parties that could be analyzed independent of the obligations mandated under PURPA.

The court held that because a hearing was required to analyze the rate contained in the EEPA and the utility's avoided costs, the PUC had substantial responsibility under PURPA to review all aspects of the EEPA and necessarily has the power to preserve the substance of the agreement during the review process. To allow the agreement to expire as a result of the administrative hearing was to obviate the need for the hearing. Further, to deprive the PUC of any ability to adjust the contract to preserve the status quo encourages parties opposed to the project to prolong litigation in an effort to kill the project.

The regulatory scheme for implementation of PURPA as developed in Pennsylvania represents a reasonable implementation of the Act. This Court recognized in *FERC v. Mississippi* that directing the individual states to implement the Act would allow great flexibility to the states and would allow the state regulatory agencies to take any action reasonably designed to give effect to the Act. In this case, the Pennsylvania PUC took action to preserve a PURPA contract so that its opponents could not use the regulatory process to achieve its failure. In affirming the PUC's decision to modify the Mon Valley EEPA here, the Commonwealth Court properly applied the rationale of *Milesburg II*.

III. PETITIONERS' OBJECTIONS TO THE RAMIFICATIONS OF THE REGULATORY REVIEW PROCESS IN PENNSYLVANIA DO NOT CONSTITUTE A LEGITIMATE BASIS FOR THIS COURT'S REVIEW

The Petitioners complain that the implementation of PURPA in Pennsylvania, as developed in *Milesburg II* and confirmed in *Shannopin II*, represents an unacceptable deviation from the federal law in three ways. None

of their objections constitute a legitimate basis for this Court's review.

A. In Pennsylvania, a PURPA contract submitted to the PUC for approval is not a "freely negotiated agreement"

The Petitioners first contend that the PUC and the reviewing courts have "dissolved" the distinction between a "freely-negotiated agreement" and "federally-mandated orders to purchase." (Pet. at 24). Because Armco and Allegheny initially sought to alter the rates contained in the agreement and were provided the opportunity to contest all of the provisions of the agreement, this is a particularly curious argument. Further, as the Pennsylvania Commonwealth Court recognized, the utility was not required to submit the contract to the PUC for approval. Because it chose to do so, it subjected itself to the possibility that the PUC would not automatically approve all the contract provisions that the utility had negotiated.

The cases from other states that Petitioners cite provide no support for their argument that the decision at issue served to blur the distinction between privately negotiated PURPA contracts and mandated purchases. Although the courts in both *In Re Vicon Recovery Systems*, 153 Vt. 539, 572 A.2d 1355 (1990) and *Public Utility Commission of Texas v. Gulf States Utilities Company*, 809 S.W. 2d 201 (Tx. 1991) discuss that distinction, neither state had established a regulatory review process like that in Pennsylvania. Thus, simply on the basis of PURPA's requirement that the individual states develop their own rules to implement the Act, those cases are distinguishable from this Pennsylvania case.

In *Gulf States*, the utility sought a determination that its contract with a QF, which contained rates in excess of avoided costs, was valid. The Texas court held that, as a voluntary arrangement, the state and federal regulations did not apply to the contract. The court recog-

nized, however, that although the utility could contract for any purchase price it chose, it risked the possibility that the Commission would refuse to allow it to recover the costs under its ratemaking powers. 809 S.W.2d at 209.

Unlike the agreement here, the contract at issue in *Gulf States* was not subject to an administrative hearing with the participation of ratepayers to ensure that the rates in the agreement did not exceed the utility's avoided costs. As the Commonwealth Court noted in this case, West Penn could have chosen not to submit the agreement to the PUC for approval. (18a). Because West Penn did seek approval, the PUC was required to review the relationship between West Penn and Mon Valley under PURPA. In accordance with *Milesburg I*, the Pennsylvania PUC was required to conduct a hearing to ensure that the rate contained in the EEPA was below the utility's avoided costs. This fundamental distinction is critical in evaluating the significance of the *Gulf States* case to this case. The Texas Commission is not required to conduct a similar review. If the Pennsylvania Commission were to permit a utility to pass through rates contained in an EEPA, even if those rates are in excess of avoided costs, then the exercise of having industrial ratepayers participate in a hearing and challenge those rates would be totally without purpose.

The Petitioners also cite *Vicon* to support their position that a "voluntary" contract submitted to the Commission for rate approval remains outside of PURPA regulation. The difference in regulatory schemes in Pennsylvania and Vermont distinguish *Vicon* from this case. Vermont, unlike Pennsylvania, does not require an evidentiary hearing to address whether the rate contained in the power purchase agreement exceeds the utility's avoided costs. Vermont does require that power purchase agreements be submitted to the Public Service Board 45 days before execution. In *Vicon*, the court held that the Public Service Board had properly denied the motion seeking ap-

proval of a negotiated agreement that had been submitted to it three years after execution. The Board found upon review the parties' conduct, there was "no necessity whatever" for the delay. 572 A.2d at 1360. The court held that this was sufficient basis for upholding the Board's action. In contrast, in the case at issue here, the judicially-mandated regulatory review process precipitated the delay. Thus, the Vermont case is of no relevance.

To the extent that ratepayers have due process input under *Milesburg I*, the Mon Valley EEPA is not a purely "voluntary" agreement between the parties. The PUC's review requires an analysis of capacity need, avoided costs and other issues critical in a determination under PURPA. The Commonwealth Court correctly recognized that here, just as in *Milesburg II*, the review process before the PUC necessarily bestowed upon the PUC certain powers to preserve the EEPA long enough to permit the evidentiary hearing and related appeals. The due process procedures and related evidentiary hearing involving ratepayers, as sought by Armco and Allegheny and required by *Milesburg I*, vary considerably from the review processes in the Texas and Vermont cases.[9]

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[9] The Petitioners' reliance on *Water Power Co., Inc. v. PacifiCorp*, 99 Or. App. 125, 781 P.2d 860 (1989), *review denied*, 309 Or. 291, 787 P.2d 997, *cert. denied*, 498 U.S. 811 (1990) and *Bates Fabrics, Inc. v. Public Utilities Commission*, 447 A.2d 1211 (Me. 1982) is equally misplaced. Under the Oregon regulatory scheme for implementation of PURPA discussed in *Water Power*, the Oregon Public Utility Commission approved rates for utility purchases from QFs established in yearly rate schedules. Thus, not only did the Oregon regulatory scheme not require a hearing with ratepayer participation to review rates, the Oregon Commission itself established the rates. In this action for breach of contract, the court simply held that a provision in a power purchase agreement that rendered the agreement void if a transmission agreement with a third party had not been executed as of a particular date was valid. In *Bates*, the parties agreed to a rate for the purchase of electricity and had entered a contract at that price *before PURPA had even been enacted.* Thus, the case is particularly inapposite here.

Just as the Petitioners attempt to ignore the significance of *Milesburg I* on the regulatory review process in Pennsylvania, they attempt to dismiss the distinctions that the Commonwealth Court recognized. Because the decisions from other states merely reflect the different methods of implementation of the Act, no conflict warranting this Court's review exists.

B. Petitioners' argument relating to "excessive rates" is unsupported here and is still subject to dispute before the PUC

Petitioners also argue that the PUC and the courts have somehow allowed the QFs to avoid contractual obligations which will subject utility customers to excessive rates. Again, their argument that excessive rates will result is not only based on a fallacy, it is still subject to dispute before the PUC. See, Appendix Y. Because that determination has not yet been made, this Court should decline review of this case.

C. The PUC's authority to modify an agreement submitted to it for approval is a reasonable mechanism for enforcing PURPA

Petitioners also object to the PUC's exercise of its authority to modify PURPA contracts and the court's recognition of that authority. This argument rests on Petitioners' assertion that the agreement between Mon Valley and West Penn was a purely private contract. The Petitioners fail to acknowledge that West Penn's submission of the contract to the PUC for approval and the regulatory review, which Armco and Allegheny sought, altered the private nature of the agreement.

In assessing the effect of the regulatory review process, the PUC and the Pennsylvania courts recognized that the PUC was authorized to analyze all terms of the contract and to modify those terms that did not comply with the Act it was required to implement. As this Court has recognized, the state regulatory agencies are best able to

evaluate the circumstances that arise in implementing the Act in the individual states. The scheme developed in Pennsylvania, allowing modification, is a reasonable and permissible regulatory tool for enforcement of the Act.

With PURPA, Congress established a regulatory scheme that allows the states to adopt different methods of implementing the Act. Thus, Congress anticipated that administration of the Act would vary from state to state. Although the Petitioners note the different applications of PURPA among the states, they fail to acknowledge that any variance was expressly within the contemplation of Congress. In addition, the cases cited by Petitioners involve fundamentally different fact patterns than that here. Petitioners' assertion that the Pennsylvania regulatory scheme differs from those of other states ignores this Court's approval, in *FERC v. Mississippi*, of the flexibility in administration that Congress envisioned. Pennsylvania's regulatory scheme properly implements PURPA. The Petitioners' objection to it is not a proper subject for this Court's review.

IV. THE PUC AND THE PENNSYLVANIA COURT'S REASONABLE FINDING THAT THE QF INCURRED A "LEGALLY ENFORCEABLE OBLIGATION" AS OF THE TIME IT ENTERED A CONTRACT WITH THE UTILITY IS CONSISTENT WITH PURPA AND SHOULD NOT BE DISCARDED FOR AN UNWORKABLE ALTERNATIVE THAT WILL EVISCERATE PURPA

A. Because the PUC and the courts continue to reject the fallacy on which Petitioners' arguments rest, Petitioners have changed their arguments as to when a "legally enforceable obligation" is established

Petitioners complain that "the utility is compelled to adhere to a pricing structure that was tied to its full avoided costs as of the date the contract was executed, even though by the time the contract was modified by PUC mandate, the utility's avoided capacity costs had

been greatly reduced and it no longer had a need for the power the PUC required it to purchase." (Pet. at 21). Because it is inconsistent with other positions taken by Petitioners in the course of this litigation and is premised on unsupported factual assertions, this argumentative linchpin is invalid. The alternative standard Petitioners now present is not only unworkable, it is contrary to the FERC regulations and would serve only to eviscerate PURPA.

In *Shannopin I*, Petitioners Armco and Allegheny asserted that "the date when the utility and the QF executed their EEPA should be used to calculate the utility's avoided costs, because that was the date when the QF was legally committed to deliver power." (283a). Those parties made the same argument in *Milesburg II*. 135 Pa.Commw. at 29, 579 A.2d at 1344. The Commonwealth Court agreed with them in both cases and directed recalculation of the avoided cost rate as of the date of contract execution.

When the PUC performed the calculation of the rates for both the Mon Valley EEPA and the Burgettstown EEPA as of October 15, 1987, the date both EEPAs were executed, West Penn, Armco and Allegheny all complained that West Penn's avoided costs as of that date were zero. In both cases, the PUC rejected this argument after an evidentiary review. The PUC recognized that West Penn's 1987 plans showed the same need for capacity demonstrated in its 1986 plans except that the 1987 plans substituted over 900 MW of PURPA projects (including the Shannopin, Milesburg and Budgettstown projects) for three 300 MW coal units. See, e.g., Appendix Y.

The Commonwealth Court affirmed the PUC's findings of capacity rates based on West Penn's avoided costs calculated as of October 15, 1987, the same date as the Shannopin EEPA in *Burgettstown II*. There, the court noted that the PUC "found the Industrials' [Armco and Allegheny] expert's testimony as to West Penn's capacity

need as of October 15, 1987, not to be credible." 629 A.2d at 227. In the decision at issue here, the court found the Petitioners argument to be "disingenuous" based on West Penn's conduct and the fact that it entered a contract with Mon Valley for Shannopin's capacity at a time it later claimed to have no need for capacity. (20a).

Petitioners now make a significantly different argument to this Court. Perhaps in anticipation of a final determination by the PUC that, as of the contract execution date, West Penn had in fact anticipated a substantial capacity need, Armco and Allegheny, with West Penn, argue that another date, the date of the PUC's order directing modification of the Mon Valley EEPA, should be used as the basis for the avoided costs analysis. However, as Mr. Justice Papadakos noted in his dissenting and concurring opinion in *Milesburg II*, in discussing Armco and Allegheny's divergent arguments as to when a "legally enforceable obligation" is established, the "self-serving shifting of dates" presented by the Petitioners "emphasizes the correctness of the rationale employed by the PUC." 634 A.2d at 212. Petitioners' efforts to circumvent the PUC's factual determination should be rejected.

B. The standard the Petitioners now advocate is unworkable and contrary to PURPA

In both *Milesburg II* and *Shannopin II*, the Pennsylvania courts determined that a legally enforceable obligation between a QF and a utility arose as of the time of contract between the patries. This standard is clearly consistent with PURPA and the FERC regulations. Had the PUC or courts adopted the standard the Petitioners now advocate, a utility's avoided costs could never be calculated. Under the Petitioners' theory, when the PUC entered an order modifying an agreement, the rate would have to be analyzed as of the date of the final PUC order. At the outset of any proceeding, the parties would have to guess when the PUC would conduct and complete a

hearing, consider exceptions or objections, and then prepare a final order. If they guessed incorrectly, then the entire review process mandated by *Milesburg I* would have to be repeated. This scenario hardly meets the objective of PURPA to encourage cogeneration and small power production. It serves only to eviscerate the principles of PURPA and would result in the type of endless litigation that the Petitioners seek.

In promulgating the federal PURPA regulations, FERC addressed the dilemma inherent in the Petitioners' proposed standard. In its comments issued with the PURPA regulations, FERC discussed how the regulations reconcile the requirement that rates for purchases from QFs equal the utilities' avoided cost with the need for qualifying facilities to be able to enter into contractual commitments based, by necessity on estimates of the utilities' future avoided costs. In response to comments that avoided costs at the time of delivery could be less than those at the time a legally enforceable obligation was incurred, FERC noted that a "minute-by-minute" evaluation of avoided costs was not required. It stressed:

> The import of this section [18 C.F.R. § 292.304(b)(5)] is to ensure that a qualifying facility which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances. This provision can also work to preserve the bargain entered into by the electric utility; should the actual avoided cost be higher than those contracted for, the electric utility is nevertheless entitled to retain the benefit of its contracted for, or otherwise legally enforceable, lower price for purchases from the qualifying facility.

45 Fed.Reg. 12,214 at 12,224 (1980).

FERC further discussed the significance of requiring that avoided costs be calculated as of the date of a "legally enforceable obligation." It noted that by using the term "legally enforceable obligation" synonymously with "contract," it intended to prevent a utility from circumventing

the avoided cost requirement merely by refusing to enter a contract with a qualifying facility. *Id.*

The Commonwealth Court recognized the significance of determining that the analysis of avoided costs be fixed as of the time a QF incurs a legally enforceable obligation to the utility. Because the court also recognized the ramifications of the regulatory review process, it also found that modifications necessitated by the review process did not alter the fact that the QF had obligated itself to the utility as of the time it entered the contract. The modifications imposed by the PUC did not alter the QF's commitment to deliver electric energy to the utility. The Commonwealth Court's determination comports with PURPA and recognizes the particular regulatory scheme developed in Pennsylvania.

C. The cases cited by the Petitioners do not support their contention that the Pennsylvania decisions are contrary to PURPA

Again, to support their argument, Petitioners cite cases from states with distinctly different regulatory schemes than that in Pennsylvania and thus with significantly different facts than those in this case. Further, none of the cases they cite support their theory as to when rates for PURPA contracts should be calculated. Their reliance on these cases is misplaced.

In *A.W. Brown v. Idaho Power Company,* 121 Idaho 812, 828 P.2d 841 (1992), the Idaho court, like the court in Pennsylvania, recognized that a legally enforceable obligation can arise at the time a QF enters a contract with a utility or at the time a QF files a complaint alleging that the project was mature and that the developer had attempted but failed to negotiate a contract with the utility. 828 P.2d at 843. There, a QF asked the Commission to direct a utility to enter a contract for rate pursuant to a particular rate schedule on the basis of an informational letter addressed to "Dear Potential Electricity Supplier." *Id.* The Idaho court found, however,

that the informational letter was not sufficient to establish a legally enforceable obligation. Because Mon Valley entered a contract with West Penn, this case is actually consistent with the Idaho court's decision in *A.W. Brown.*

In *Petition of East Georgia Cogeneration,* 158 Vt. 525, 614 A.2d 799 (1992), the court deferred to the Board's discretionary judgment that a QF was not entitled to a certificate of public good, finding that the proposed rates exceeded the utility's avoided costs. The court made no attempt to set a rigid rule for determining when a "legally enforceable obligation" was established. Thus, *East Georgia* provides no support for the Petitioners' argument.

Because it seeks to encourage the development of QFs at rates that do not exceed a utility's avoided costs, Pennsylvania's regulatory scheme is consistent with the goals of PURPA. The fact that the utility has joined with its industrial customers in their petition to this Court serves only to emphasize the disparity in the arguments throughout these long and arduous proceedings that the parties have used in contesting this project. In the absence of a federal issue, this Court should decline to review the Petitioners' contrived and factually unsupported arguments.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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